



Jim Doyle
Governor

State of Wisconsin • DEPARTMENT OF REVENUE

2135 RIMROCK ROAD • P.O. BOX 8933 • MADISON, WISCONSIN 53708-8933 • 608-266-6466 • FAX (608) 266-5718 • <http://www.revenue.wi.gov>

Roger Ervin
Secretary of Revenue

Testimony of Diane Hardt, Tax Administrator Wisconsin Department of Revenue

Senate Committee on Tax Fairness and Family Prosperity
February 20, 2008

Chairman Jauch and Members of the Committee:

Thank you for the opportunity to speak today in support of Senate Bill 446 that conforms Wisconsin to the provisions of the Streamlined Sales and Use Tax Agreement. I also hope to inform you more about the Streamlined Sales and Use Tax Agreement and the Streamlined Sales Tax Project.

I served as chair of the Streamlined Sales Tax Project from its inception in March 2000 to the fall of 2007, almost 8 years. The 22 states that have adopted the conforming legislation have now assumed governance of the Streamlined Sales Tax Project, as planned in the Streamlined Sales and Use Tax Agreement. I have stepped down from my leadership role.

Before I begin the power point presentation, I want to make a couple of points about the conforming legislation:

1. Wisconsin has had a significant voice in determining the uniform definitions, procedures, and requirements in the SSUTA. Compared to other states, Wisconsin's conforming legislation is not difficult to achieve. Wisconsin should have a voice and should continue to lead this effort. There is constant pressure from Congress and the multi-state business community for the states to conform in state tax laws.
2. Businesses, especially multi-state businesses, are actively involved and supportive of the simplification and uniformity provided in the SSUTA. Consider Kwik Trip's tax compliance costs when Iowa, Minnesota and Wisconsin define soft drinks, candy and prepared food inconsistently; or GE and Apria Health Care's tax compliance costs when they sell thousands of medical instruments that are defined by states in many ways; or AT&T, Verizon and Time Warner Cable's compliance costs when the telecommunication and cable TV services are defined, bundled and sourced in many different ways by different states; or Microsoft and Apple's compliance costs when software is inconsistently defined; or Wisconsin's own Kohls and Lands End's compliance costs when clothing items have many different tax definitions and tax treatments.

These companies have helped define these items so as to establish bright lines and clear procedures. Simplification and uniformity is as important to them as the level playing field is important to the main street business competing with the Amazons of the world.

We have accomplished much in the Streamlined Sales and Use Tax Project and Agreement. I believe you will see many more states stepping up to adopt the conforming legislation in the next couple of years. I would hope Wisconsin would move ahead in adopting a sales and use tax for the 21st century.



Wisconsin Merchants Federation

"The Voice of Wisconsin Retailing"

1 East Main Street, Suite 305
Madison, Wisconsin 53703
Telephone 608/257-3541
Fax 608/257-8755
E-mail wmf@wismerchants.com

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The Board**
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Kohl's Department Stores
Menomonee Falls

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Chris C. Tackett

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SPECIAL MEMORANDUM

**To: Members, Senate Committee on Tax Fairness and
Family Prosperity**

Date: February 20, 2008

From: Chris Tackett, President & CEO

**Subject: WMF Supports SB 446
Main Street Equity Act (Streamline Sales Tax)**

"DON'T PLAY HARDBALL WITH LITTLE LEAGUE"

This discussion about the Main Street Equity Act, previously known as the Streamline Sales Tax project, - could not be held before a more appropriately named committee.

There is nothing "Fair" about a tax policy that hurts Wisconsin's main street retailers while helping out of state sellers. And for hundreds of Wisconsin independent jewelers - their "Family Prosperity" is at risk.

Any body with cable or satellite TV has access to numerous channels selling jewelry 24 hours a day as well as the Internet. Yet none of these sites collect Wisconsin sales taxes. Internet sales continue to rise by 25% each year.

Our current sales tax law rewards those out-of-state sellers - while denying Wisconsin's brick and mortar stores on Main

Street the ability to compete. Check any Little League field fence throughout the state and you won't see such names as E-Bay, Blue Nile, Amazon.com, or L.L. Bean. The names you see on the fences are local businesses that pay property taxes, pay income taxes, employ thousands of Wisconsin citizens - - and collect state sales taxes. They are an integral part of the local and state economy. Their internet competitors exist in cyberspace - - which the U.S. Supreme Court has ruled has no nexus in Wisconsin.

We applaud Senator Jauch's continued efforts to help Wisconsin's main street merchants.

We urge you to pass this Main Street Equity Act. It will add another state to the fold urging Congressional action.

Let's not "Play Hardball with Little League" any more!!

Thank you.

Chris Tackett
President & CEO
608-257-3541
chris.tackett@wismerchants.com



Wisconsin Manufacturers & Commerce

Wisconsin Manufacturers'
Association • 1911

Wisconsin Council
of Safety • 1923

Wisconsin State Chamber
of Commerce • 1929

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Vice President
Administration

TO: Senate Committee on Tax Fairness and Family Prosperity

FROM: Jeff Schoepke, Director, Tax & Corporate Policy

DATE: February 20, 2008

RE: Senate Bill 446, the Streamlined Sales and Use Tax Agreement, and the *Menasha* Decision

Senate Bill 446 (SB 446) makes significant changes to Wisconsin's sales tax code to make this state a full member of the Streamlined Sales and Use Tax Agreement (SSUTA). SSUTA is an attempt to modernize sales tax codes across the United States to account for changing retail habits of consumers. WMC recognizes there are significant fairness issues with the separate tax treatments applied to "brick and mortar" retailers and online and catalog sellers. Treating similar transactions similarly is a fundamental principle of tax fairness and WMC therefore agrees with the underlying premise of the effort.

There are, however, several unresolved issues and questions with SSUTA. WMC does not support SSUTA membership for Wisconsin at this time.

Of most immediate concern is the SSUTA's definition of computer software, which overturns the recent Court of Appeals decision in *DOR v. Menasha Corp.* That decision upheld state statutes exempting custom software from sales and use taxes. The concerns over *Menasha* are the focus of this memorandum.

DOR v. Menasha

In *DOR v. Menasha Corp.* the Court of Appeals upheld a Tax Appeals Commission decision that found Menasha's Corp.'s purchase of custom computer software was not subject to sales tax under state statutes or administrative code. The software in question consisted of over seventy modules providing business and accounting software for different segments of the company's business. The software is not usable as sold, and must be modified to fit a business' specific operational requirements. In fact, Menasha Corp. spent more than \$17 million beyond the cost of the underlying core system to make it fit their needs. Yet, DOR called this system "pre-written".

Wis. Stats. 77.51(20) specifically exempts "custom computer programs" from the definition of tangible personal property subject to the sales tax. State law does not, however, define "custom computer programs".

DOR defines "custom programs" in TAX 11.71(1)(e) of Administrative Code. That definition includes seven components which must be considered when determining whether programs are "custom" or "pre-written". In its assessment, DOR considered only two of the seven

components. The Tax Appeals Commission concluded that Menasha Corp.'s software was "custom" under both statutes and administrative code.

The Circuit Court ruled in favor of DOR, but in a unanimous decision written by Judge Paul Higginbotham, the Court of Appeals ruled that DOR should have considered all seven rule components, and that the Tax Appeals Commission's determination was "reasonable". The Supreme Court heard oral arguments on the State's appeal in November, 2007, and will rule in the matter sometime this year.

It is unclear exactly how many companies in Wisconsin have substantially similar software systems so as to be affected by the decision. It is generally understood, however, that many companies have filed protective refund claims. DOR's public estimate is \$250 million in outstanding refund claims and ongoing revenue reductions exceeding \$26 million annually. Given that \$26 million of sales tax revenue equates to approximately \$520 million in sales of such software every year, industry tax experts generally believe DOR's estimate is too large. Nonetheless, for any particular company the amount may be substantial.

Menasha and SSUTA

As noted earlier, SSUTA member states agree to a uniform set of definitions for goods and services, and then decide individually whether to tax or exempt the defined product. The SSUTA definition of software is problematic for *Menasha*, as it combines pre-written and custom software into one definition, thus preventing Wisconsin from taxing pre-written and exempting custom software. Thus, if it were to adopt the SSUTA, Wisconsin would be faced with the decision of either taxing all software sales, and overturning *Menasha*, or exempting all software sales from tax, including pre-written or canned software such as the Microsoft Office suite, the tax status of which has never been in question.

Regardless of how the Supreme Court rules, the Wisconsin legislature will, at some point, need to deal with the difficult issues of what software sales it intends to tax.

However, until the significant legal issues are addressed by the Supreme Court, WMC cannot support the agreement.

Recommendation

The Legislature should not act to join the SSUTA at this time. Once the Supreme Court completes its review of *Menasha*, it would be appropriate for the Legislature to revisit the issue, but unanswered questions make action at this time premature.

If you have questions or concerns about this matter, please feel free to contact me at 258-3400 or jschoepke@wmc.org.



Writer's Direct Dial: (262) 703-6016
Facsimile (262) 703-6143
E-mail: joseph.malloy@kohls.com

February 20, 2008

State Senator Robert Jauch, Chair
Committee on Tax Fairness and Family Prosperity
118 South
State Capitol
Madison, WI 53702

RE: Support of Streamlined Sales Tax Legislation in Wisconsin

Dear Senator Jauch and Committee Members:

I am writing today to express Kohl's Corporation's strong support for the Streamlined Sales Tax proposal in Wisconsin, in conjunction with my testimony to the Committee on Tax Fairness and Family Prosperity.

Kohl's is headquartered in Menomonee Falls, and operates more than 900 retail department stores across the country, including 37 stores in Wisconsin. We employ over 9,000 Wisconsin residents in our stores, corporate headquarters, and one distribution center. Kohl's also makes internet sales to customers through our kohls.com web site.

For Kohl's, and for all Wisconsin businesses, this is a matter of tax fairness. All retailers who do business in the state should collect sales tax, but they do not. We have a physical presence in the state, and we're required to charge sales tax on our store sales and e-commerce sales, but other companies without a physical presence in Wisconsin can make sales of merchandise to Wisconsin residents without charging tax. This puts Kohl's at a distinct competitive disadvantage, and the situation is no different for other Wisconsin businesses.

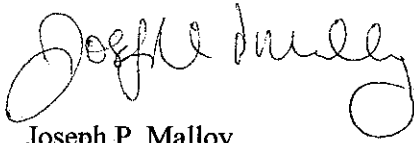
We support a level playing field for all merchants, regardless of whether sales are made at a storefront, over the internet on a web site, or through a catalog. We believe that tax policy should be channel-neutral, and all retailers should be required to play by the same rules.

We also support the efforts of the Streamlined Sales Tax Agreement to use common, uniform definitions within the tax laws. We operate as a multistate business, and it is important for our compliance to have common, clearly defined state-by-state tax rules. This is a major achievement, and a step towards tax simplification and overall good tax policy.

The simplification of Wisconsin's sales tax collection process will help us move closer to having a level playing field for Wisconsin businesses, including Wisconsin's Main Street merchants, stores in Wisconsin shopping malls, and major Wisconsin retailers such as Kohl's and catalog companies like Lands' End.

Kohl's sees this as a positive step for business in Wisconsin. Once the state is able to collect sales taxes that are owed from remote vendors who currently don't collect these taxes, the Legislature should be able to focus on important legislation to strengthen our economy and overall business environment, including tax reductions, sales tax holidays, and other economic development measures.

Sincerely,

A handwritten signature in cursive script, appearing to read "Joseph Malloy".

Joseph P. Malloy
Tax Manager
Kohl's Department Stores